

27/81

Financial Markets



Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

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This week was very trying for financial markets, as continuing uncertainties in the near-term outlook forced interest rates sharply higher. Most disconcerting to the markets was the fact that the interest rate on Federal funds remained stuck in the 19%-20% range.

Nevertheless, signs continue to point toward an easing of the Fed's policy stance, and by Friday the markets were beginning to come around to that view. Though some participants had expected the Fed's outright purchase of securities on Wednesday, correctly surmising that the action would cover part of a seasonal reserve need in coming weeks, the operation was by no means necessary at that time. Had the Fed wanted to keep up pressure on bank reserves positions—and thus also on the Fed funds rate—the action could easily have been postponed for a few weeks. The same desire to assure availability of reserves seemed to characterize the Fed's execution of one-day and four-day repurchase agreements on Thursday. The same weekly average reserve injection could have been achieved by doing the job on Friday, but if the Fed intended to reduce pressure on banks to borrow from the discount window on Friday night, then injecting reserves at the earliest possible moment in the new statement week made excellent sense.

Contributing to the tension in the reserves market was the prospect of distortions that might be caused by the transfer of \$2.3 billion of Iranian deposits from U.S. banks. Though the transfer should not affect overall reserves availability, the efforts of banks paying funds to cover their positions undoubtedly contributed to some pressure on the funds market. Of course, it is useful to keep perspective on the scale of the problem. Last January, when the first transfer of Iranian assets took place, the potential impact on bank reserves positions was much greater, but the Fed handled the problem adeptly, and there was little doubt that distortions would be minimized this time as well.

In a nutshell, evidence continues to accumulate pointing to near-term declines in interest rates well beyond the modest corrections posted so far in today's trading. Nevertheless, there are some probable constraints on the magnitude of the coming rally. Most important, for reasons discussed here previously, the Fed is likely to persist in its cautious approach to control of money growth. In addition, the next several weeks include a period of seasonal reserve losses by banks; though the losses will be made up by the Fed, the prospect does not augur well for a precipitous drop of the funds rate. Moreover, in the long-term sector, investor interest has been very slack for the most part, while the backlog of corporate bond issues waiting to come to market is of historically extraordinary proportions. While the prospect of massive supplies of new bond issues certainly need not preclude a rally in that sector, it does suggest that rate declines will be tempered by the difficulties faced by underwriters dealing with such congestion.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

	(Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.50%	20.00%	11.50%
Effective since	7/8/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	11.00
Federal Funds	19.25	19.75	9.13
Repurchase Agreements	18.75	19.00	8.25
U.S. Treasury Issues			
Bills			
3 months	15.64	15.02	8.25
6 months	15.78	15.28	8.50
1 year	15.35	14.91	8.60
Coupons			
2 years	14.94	14.73	9.00
4 years	14.55	14.38	9.35
7 years	14.01	14.07	9.60
10 years	13.94	13.86	10.20
Long Bond	13.26	13.31	10.25
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.50	17.70	8.65
3 months	17.85	17.30	8.75
6 months	17.35	17.00	8.85
1 year	16.50	16.00	9.50
Banker's Acceptances			
1 month	18.50	17.75	8.50
3 months	17.80	17.30	8.70
6 months	17.30	17.00	8.80
Eurodollar Deposits			
1 month	19.19	18.63	9.13
2 months	18.75	18.25	9.25
3 months	18.56	18.25	9.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.00	18.50	6.00
1 month	17.75	17.00	8.38
3 months	16.75	15.00	8.38
Bank Holding Companies			
1 month	18.00	17.25	8.50
Dealer Placed:			
3 months	NA	NA	8.13
New AA Corporate Utility Bond	15.88	15.50	12.00
Tax Exempt			
6 month Project Notes	7.60	7.30	4.80
1 year AAA Bond	7.75	7.55	5.25
5 year AAA Bond	8.40	8.70	5.45
20 year AAA Bond	10.20	10.10	7.10

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the off-red side of the market.

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